

JAPAN

Overview

Japan is the world's second largest economy after the United States. After nearly twenty years of high growth, Japan suffered through several years of anemic growth in the early 1990s. Japan's long-awaited economic recovery is now showing signs of sustainable, yet modest, momentum. The yen, which reached record highs in 1995, has weakened somewhat recently, but has stimulated imports (up 23 percent in 1995) while also prompting many Japanese companies to move production overseas in order to service export markets and to deal with Japan's high labor and material costs. Japan remains the second largest market for U.S. exports after Canada, and Japanese companies and consumers are showing increasing willingness to purchase lower-cost, foreign goods, services, and equipment. In short, despite difficulties in recent years and the unevenness of the current recovery, Japan remains a large and growing economy that presents excellent opportunities for U.S. firms.

Defense Industry Environment

Japan's defense requirements in recent years were driven primarily by the potential threat of the Soviet Union's substantial force structure in Soviet Asia. This resulted in six percent increases annually in Japanese defense spending during the 1980s. However, the end of the Cold War has triggered a re-evaluation of Japan's security requirements. The continued existence of major Russian forces in Siberia which constitute a potential threat, the prospects of a unified Korea, and an increasingly assertive China will be part of Japan's security strategy. Additionally, the Japanese Self Defense Forces face new requirements for mobility and long range deployments to accomplish their new mission of participation in peace keeping operations.

The FY 1997 Japanese defense budget is expected to increase by only 1.98% (after several years of equally low growth) and this flat trend in defense spending is expected to continue for the near future. These figures further reflect a level of defense spending that amounts to 0.94% of Japan's GDP. This level is the lowest since 1993. An increasing amount of available funds will be spent on training programs and improving the quality of life for personnel and somewhat less will be left for procurement. Within the procurement budget, less will be spent on hardware (0.7% increase). However, the Technical Research and Development Institute budget will increase by 6.1%. Approximately 146 billion yen will allocate to 55 new projects.

Nevertheless, Japan's defense budget, at around \$48 billion, is still the world's fifth largest and it will annually import over \$2 billion dollars worth of equipment from the United States. Although Japan's procurement budget (about \$10 billion) is large, a significant portion of it is required for four expensive programs, the Multiple Launch Rocket System (MLRS), the AWACS airborne early warning system, the F-2 fighter aircraft, and the AEGIS guided missile cruiser, all of which are being either licensed, imported, or jointly developed with the United States.

The Japanese defense industry is dominated by twelve leading companies which account for approximately 95% of JDA's acquisition budget. These companies include so-called "heavy" industries and several large electronics manufacturers. Since the mid-1980s, defense production has been approximately 90% local with about 10% overseas procurement. However, as noted above, there is a great deal of license production with the majority involving U.S. firms. The "heavy" industries average from 50-75% license production while the electronics companies' license production averages around 25-50%.

Compared to Japanese industrial production as a whole, the defense sector is comparatively small as a result of stringent laws prohibiting export of military and military-related equipment. Within the major defense companies, defense production accounts for a relatively small portion of their overall business. Consequently, Japanese corporations are hesitant to spend money and effort to develop military technology unless it contains dual-use applications. They would rather buy military technology from abroad, preferably from the U.S., through licensed production or as hardware components to be integrated into Japanese systems. Many major license production and co-production programs such as FS-X/F-2, F-15, SH-60, and others appear at first glance to be Japanese, however, upon closer inspection, actually have a high percentage of components imported from the U.S. This is one of the reasons for the high volume of imports from the U.S.

The twelve leading Japanese defense companies are listed below:

- Mitsubishi Heavy Industries, Ltd. (ships, military vehicles, aircraft, missiles)
- Kawasaki Heavy Industries, Ltd. (ships, aircraft)
- Ishikawajima-Harima Heavy Industries, Co., Ltd. (ships, engines)
- Mitsubishi Electric Corporation (electronics, missiles)
- Toshiba Corporation (electronics, missiles)
- NEC Corporation (electronics)
- Fuji Heavy Industries, Ltd. (aircraft)
- The Japan Steel Works, Ltd. (artillery)
- Komatsu, Ltd. (small arms/ordnance, military vehicles)
- Hitachi, Ltd. (electronics, military vehicles)
- Oki Electric Industry Co., Ltd. (electronics)
- Daikin Industries, Ltd. (small arms/ordnance)

Defense Opportunities

U.S. defense systems and equipment have a good reputation in Japan and the Japanese defense industry sees itself as five to ten years behind the United States in systems integration, with little hope of closing the gap over the next decade. However, in the area of components and basic technology, Japan's defense industry sees itself only slightly behind the U.S. with a good chance of surpassing U.S. industry in many dual-use technologies.

Defense trade opportunities exist for U.S. firms in the following industry and/or technology areas:

- Missile technology (AAM, ASM, SAM)
- Air Defense Systems
- Target Acquisition Systems
- Defense Electronics (particularly upgrades)
- Avionics
- C3I (OTH Radar, Have Quick/JTIDS, GPS, Maritime Surveillance)
- Semiconductor components
- Logistics Software (CALS)
- Information Systems
- Signals Processing

Defense Procurement Process

The JDA operates a Central Procurement Office which handles most military procurement. In theory, a foreign company can sell directly to the JDA. However, in practice, the JDA will buy commercially only from a Japanese prime contractor (such as Mitsubishi Heavy Industries) or a trading company such as Sumitomo, or C. Itoh. They will buy from the U.S. Government, when required, through the Foreign Military Sales system. Japan is also starting to adopt some of the DOD acquisition reforms, to include reliance on international military specifications (versus Japan-specific standards), and increased off-the-shelf procurement.

To successfully enter the Japanese defense market, it is highly advisable to establish a joint relationship with a Japanese manufacturer or trading company. These organizations are particularly adept at navigating the Japanese procurement and distribution networks, gathering information about sales opportunities, and marketing products. Often they have good connections with the JDA and employ former JDA employees. Moreover, in order to establish a successful business presence in the Japanese market, it is important to develop a long-term business relationship with a Japanese company based on mutual trust. The Japanese partner or trading company can play the role of trusted third-party intermediary to the JDA on behalf of a U.S. firm that is new to the market.

Diversification/Commercial Opportunities

Due to ongoing deregulation and the continued opening of markets to foreign products and services, substantial opportunities exist for U.S. defense firms in dual use or related technology fields. In fact, with Japanese defense spending likely to remain flat for the near future, commercial opportunities may be more promising than direct military sales. Significant export opportunities offering near-term growth potential and/or a large market receptive to U.S. suppliers are listed below.

Telecommunications Equipment

As a result of U.S.-Japan agreements to open Japan's telecommunications market, few overt barriers remain. Japan's market is very competitive in almost all subsectors. Japan's proposed National Information Infrastructure (NII) is expected to develop into a \$1.4 trillion market by the year 2010 when the nationwide fiber-to-the-home network is completed. The major player in both the NII and the Japanese telecommunications market is Nippon Telegraph and Telephone (NTT). NTT is the single largest purchaser of telecommunications equipment in the Japanese market, purchasing over \$1 billion worth of foreign products in fiscal year 1995. Besides NTT, new common carriers (NCC's) and the public utility sector's electric power companies are good potential customers for U.S. equipment suppliers. The most promising sectors within this \$30 billion market include: (1) internetworking equipment such as routers, frame relay switches, and ATM switches ; (2) multi-media software and hardware, including CATV; (3) radio communications equipment; and (4) communications satellites.

Electronic Components

This is a nearly \$57 billion market and is expected to grow approximately 21 percent in 1996. Despite intense competition from Japanese companies, this market is one of the world's largest and most attractive for U.S. suppliers. Particularly promising areas include semiconductors, especially in the multimedia subsector (1996 predicted overall sales of \$34 billion), and Liquid Crystal Display Devices/Panels (1996 predicted sales of \$7.5 billion). The market for other passive components will remain small due to continuing weak consumer demand.

Medical/Diagnostic Equipment

As the "graying" of Japanese society continues, the Japanese Government is increasing expenditures for improvement of social infrastructure, including health and welfare facilities. This will increase demand for products for the elderly as well as innovative medical systems equipment. Japanese physicians and other medical professionals generally look to the U.S. for innovative and advanced products, but some criticize the lack of good after sales service by U.S. suppliers. The import market, which currently accounts for about 30 percent of the total \$17 billion market, should expand 5-8 percent annually in the foreseeable future. The U.S. has about two thirds of the import market. The most promising areas in the medical equipment market include: implants such as pacemakers, artificial heart valves, and artificial joints; anesthesia equipment and laparoscopic surgery devices; and, diagnostic imaging devices, including high quality ultrasound, CT and MRI equipment.

Aircraft and Parts

While the U.S. still maintains a commanding lead in aircraft and components, Japanese aircraft exports have been expanding in recent years, and European manufacturers have entered into the Japanese market. Cooperative ventures among U.S., European, and Japanese firms have increased markedly in recent years. Japan's general aviation market is small, as few companies or individuals own their own aircraft. The most promising subsectors within the \$9 billion dollar market are: civil aviation jet aircraft; aircraft engines and parts; and general aviation aircraft, including helicopters and executive jets.

Computers and Peripherals

This is a huge (\$55 billion) market and is expected to continue growing. Market access for U.S.-made PC's has improved dramatically in recent years. The Multimedia PC/Workstation subsector is particularly attractive and 20-25 percent annual growth until 1997 is forecast. U.S. suppliers have a leading market position in client/server and parallel processing systems, although Japanese competitors are increasingly focusing on this area. Although less vibrant than the PC/Workstation sector, the market for large mainframe computers and peripheral systems is expected to grow 13-14 percent in 1996.

Computer Software

U.S. suppliers are extremely competitive in this market, which should expand from its current \$9 billion to over \$11 billion by 1997. PC software accounts for about 45% of the entire software market, while custom software for large and mid-range computers and workstations will have annual growth of 5-7 percent over the next several years. Packaged software will show annual growth of approximately 30 percent during this period. Particular demand is forecast for software for CAD systems and accompanying workstations, as well as PC packaged software, CD-ROM software, and network software.

Security and Safety Equipment

The home security industry in Japan is still a fairly new market. It has demonstrated steady growth (approximately 10 percent) in recent years but from a small base. As the number of break-ins of commercial and residential facilities continues to rise and as the cost-consciousness of proprietors and the disposable income of residential consumers increase, medium-term prospects for this sector should remain promising. Most promising subsectors include: observatory cameras and systems, residential security/safety equipment, information panels, access control equipment and systems, and burglar sensor systems.

Environmental and Pollution Control Equipment

The Japanese government and municipalities continue to strengthen their environmental protection and pollution control regulations. The market is expected to expand nearly 10 percent to over \$19 billion in 1997. In particular, Japan's imminent adoption of the ISO 1400 on environmental management and auditing may act as a major driving force, expanding further market opportunities. The Japanese market is quite competitive, but there is a substantial U.S. export potential for state-of-the-art U.S. equipment and services, particularly those utilizing biotechnology applications for waste treatment and contamination remediation. Also, cost effective U.S. technology dealing with soil and groundwater contamination has high sales potential in the Japanese market.

Government Procurement Process

In addition to sales opportunities in the private sector, there are good prospects in the government procurement arena. Some of the key ministries offering procurement opportunities are listed below:

- Ministry of Post and Telecommunications
- Ministry of Health and Welfare
- Environmental Agency
- Science and Technology Agency
- Ministry of Transport
- Ministry of Construction
- Nippon Telegraph and Telephone (60% government-owned)

Japanese Government entities are interested in purchasing a wide range of products from telecommunications equipment, computer equipment, and scientific and testing instruments to other, less sophisticated products and supplies. Recent changes in Japanese government procurement as a result of the Framework Negotiations and the GATT Uruguay Round have greatly expanded the scope of contracts that U.S. suppliers can bid on.

In most cases, Japanese government tender solicitation documents are in Japanese only with only brief English-language summaries. Tender documents must be submitted in Japanese only (Nippon Telegraph and Telephone (NTT) tenders may be submitted in English). To facilitate information gathering and applications for tender documents, it is strongly recommended, although not mandatory, that the U.S. supplier appoint an agent or representative in Japan.

To become a qualified supplier, firms and/or their agents must apply for qualification screening. Each Japanese government agency specifies in the Kampo (the Japanese Government's Official Gazette) an open application period prior to the beginning of the Japanese fiscal year which starts April 1.

Specific tender notices are published in the Kampo generally fifty days prior to the time of bid. Under the provisions of the GATT Procurement Code, foreign companies are permitted to bid on specific invitations prior to qualification provided there is sufficient time to complete the qualification procedures.

U.S. Suppliers can find summaries of translated tender announcements on the Economic Bulletin board (EBB), the Commerce Business Daily, the National Trade Data Bank, and a new JETRO Database which is available on the Internet at "<http://www.jetro.go.jp/>". U.S. Department of Commerce district offices can also assist potential U.S. bidders by identifying firms that provide translation services.

Doing Business in Japan

There is no short-cut to selling in Japan. In-country representation is crucial as well as a long-term commitment to the Japanese market. Sales service, customer support and the development of a proven track record are vital.

Commercial success in Japan tends to be directly correlated with the strength of a company's personal relationships with its Japanese business partners and customers. Although a U.S. firm may have a high quality, innovative, competitively priced product, the company will not succeed unless it builds and cultivates good personal relationships. It is strongly recommended that U.S. firms establish a presence in the market by establishing a representative or branch office in Japan. If this is not possible, a Japanese partner, in the form of an agent, representative, distributor, or joint venture partner will be the key to success in the Japanese market.

The basic keys for commercial success in Japan are briefly described below:

- Be committed to the market
- Build a positive company image
- Demonstrate patience
- Do adequate research prior to market entry
- Appoint a manager for Japan operations
- Develop personal relationships
- Find, attract, choose, and keep a quality Japanese business partner
- Follow-up is essential
- Listen to the Japanese partner and customer
- Adapt products to the Japanese market
- Competitive pricing
- Provide quality sales and customer service
- Learn how things are done in Japan

Trade Barriers

Over the past few years, the Japanese Government has removed most formal barriers to the import of goods and services. Most goods now qualify as “freely importable” and do not require an import license. Also, the average applied tariff in Japan is one of the world’s lowest. Current obstacles to selling in the Japanese market do not fit into conventional trade barrier categories. Instead of tariffs (averaging 2.9%) and official discrimination against imports, American exporters face a number of factors that raise costs and inhibit access. These include the tangle of government red tape, lack of transparency in import certification and approval procedures, the high cost of land, and an outdated and fragmented distribution system, close ties among Japanese competitors, and skeptical attitudes towards foreign suppliers by some government and business executives.

Taxation

The three percent consumption tax (which may soon rise to 5 percent) is essentially a value-added sales tax and is levied at the time of each resale, starting with customs clearance into

Japan (at which time it is levied on the c.i.f. value, plus import tariff). Retail sales are also subject to the three percent consumption tax. Royalties, including licensing royalty payments, are subject to a 20% withholding tax, which can be reduced to ten percent under the 1971 U.S.-Japan Double Taxation Treaty. Local branches of foreign firms are generally taxed only on income derived from within Japan. Calculation of taxable income and allowable deductions, and payments of the consumption tax for U.S. firms in Japan are similar to the tax regulations faced by Japanese companies.

Licensing of Technology

You should carefully consider the suitability of this approach. Licensing product technology can immediately contribute to a company's bottom line with little investment or direct cost. However, licensing is a very limited form of market participation. High potential returns from marketing and manufacturing efficiencies are lost, and very little market information is gained. Often licensing agreements prove to be short-lived as the Japanese licensee improves upon the American product or technology and then exports the improved product back to the United States -- thereby becoming a major competitor.

The wisdom of licensing technology depends on the status of a company's patents in Japan, together with the degree to which the company must disclose trade secrets to its licensee. The key to success in a licensing agreement is to have a partner whose goals coincide with those of the American company. The American company should maintain close contact with the licensee and keep current on the Japanese market by visiting Japan regularly. Also, it may be important to reinforce license rights by maintaining tight control over their trademark, patent, or copyright.

In cases where a foreign company wishes to grant a license to an independent Japanese corporation, to its wholly-owned Japanese subsidiary, or to a joint venture corporation in Japan, the Ministry of Finance must be notified through the Bank of Japan. In some instances, it may be necessary to also notify the Fair Trade Commission. More stringent regulations apply to "designated technologies" that have been determined to have significant influence on the security of the nation and the national economy.

Foreign Investment Restrictions

One hundred percent foreign capital is allowed except in the following sectors: broadcasting, telecommunications, electric power generation, domestic rail and air transportation, arms, gun powder, atomic energy, aircraft, space development, narcotics manufacturing, vaccine manufacturing, security guard services, agriculture, forestry and fisheries, and petroleum refining and marketing.

Intellectual Property Rights

Although Japan has signed the Paris Convention for the Protection of Industrial Property and other treaties governing the protection of industrial property rights, there are deficiencies in

its intellectual property laws and problems involving protection of patents, copyrights, and trademarks. Thus, U.S. firms should take the steps necessary to obtain and protect their intellectual property through patents, trademarks, copyrights, and other intellectual property rights in Japan.

U.S. Government Points of Contact

Entering the Japanese market, particularly its complicated distribution system, requires commitment and a systematic, well thought out approach. It is highly advisable for prospective exporters to take advantage of export assistance offered by the U.S. Department of Commerce.

Japan Export Information Center (JEIC)

The Japan Export Information Center within the U.S. Department of Commerce offers business counseling and provides current and accurate information on exporting to Japan. The JEIC provides information on doing business in Japan, market entry alternatives, market information and research, product standards and testing requirements, tariffs, and non-tariff barriers. The staff also maintains a commercial library and is available to participate in private and government-sponsored seminars on doing business in Japan. The JEIC can be reached at the following address and phone number:

U.S. Department of Commerce
Japan Export Information Center
Room 2320
14th Street and Constitution Ave., N.W.
Washington, D. C. 20230
Tel: (202) 482-2425
Fax: (202) 482-0469

U.S. & Foreign Commercial Service (US&FCS)

The U.S. & Foreign Commercial Service staff located in Japan maintains offices in Tokyo, Osaka, Nagoya, Sapporo, and Fukuoka. These individuals report on commercial developments, identify trade barriers, prepare market research, counsel U.S. exporters on business practices and opportunities, coordinate U.S. participation in and organize trade events, and introduce exporters to Japanese buyers. The US&FCS point of contact is:

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